4/26/88 B5350-2

MANUFACTURERS HANOVER

Financial Digest

Volume XXV, Number 9 Monday, April 25, 1988

Analysis of Business Trends Plus Selected Financial Indicators

"Fine Tuning" At The Fed?

If there is one sport within the financial community with nearly universal sidelines participation, it is the Federal Reserve policy guessing game. The rules are few and the required equipment is minimal, except perhaps for a daily newspaper and an opinion; the object of the game is essentially to see who can be the first to spot a shift in the stance of the central bank. This is usually accomplished by attaching policy significance to even the slightest wiggle in the Federal funds rate, or to changes in bank reserves and discount window borrowings. Even the Fed encourages participation in its own way by making public its policy intentions only well after the fact.

The best time to play this game is when both the economic and the inflation rate statistics are mixed. This is because with the direction of the economy and prices less than clear-cut, each new government number has the capability of unleashing a flurry of contradictory speculation as to what the Fed is, should, or will be doing. In recent weeks, activity in this sport has reached new heights. This is partially the result of the usually inconclusive barrage of business statistics, but it also stems from a growing belief that the Fed is attempting to "fine tune" monetary policy–in other words, frequently altering policy in anticipation of what may be emerging trends in the direction of the economy, inflation, or both.

In this environment, the government's often revised, often incomplete monthly business statistics assume an importance far beyond their reliability. Whereas in the early 1980s, the markets focused on money growth and whether or not it was within the announced target ranges, now they zero in on such statistics as payroll employment, durable goods orders and the trade balance, scrutinizing them closely for clues as to the health of the economy and, based upon their diagnosis, forming snap judgments as to the presumed Fed response.

Since so many economic statistics are churned out by Washington, one obvious casualty is market stability. Depending upon the perceived importance of the statistic, market sentiment–not to mention bond and stock prices–get whipsawed around not only on a month-to-month basis, but virtually on a day-to-day, if not hour-to-hour basis. The markets plainly seek to stay one step ahead of the Fed–which is believed to be trying to stay one step ahead of the economy and the financial markets.

Bond Market Blues

Take, for example, the recent uptick in the Federal funds rate. During the two week period ending April 13, the funds rate–the cost of overnight money which banks lend to one another, and which is directly influenced by central bank policy actions–averaged about 6.80 percent. Since this was about 30 basis points higher than the mid-March average, and it came on the heels of a 260,000 person increase in payroll employment in March, the bond market concluded that the Fed was worried about the strength of the economy, had tightened monetary policy, and would soon be tightening some more. This view gained added credence when it was reported that producer prices rose 0.6 percent in March, month over month, and a hefty widening of the merchandise trade deficit in February touched off a dollar sell-off. Such evidence to the contrary as the easing of the number of factory jobs in March, the virtual flattening of industrial production last month and the faltering of automobile sales in early April was shrugged off; bond prices tumbled and long-term yields spiked higher.

But just two months earlier, in early February, the financial markets were convinced of the opposite. At that time, a large pileup of inventories in the fourth quarter of last year had the markets sensing hefty production and employment cutbacks right around the corner and expectations ran high that a decided easing of monetary policy was imminent. Long-term bonds appeared to be a good bet, since bond prices moved higher and yields lower. This sentiment lasted until early March, when a reported surge in February payroll employment diminished recession fears.

Manufacturers Hanover Economics Department 17/270

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To be sure, at least one Fed governor has stated that the Fed should more closely watch such barometers of market sentiment as the yield curve and trends in the dollar's external value. This does not mean, however, that monetary policy is as fickle as bond or foreign exchange market sentiment. While these may act as policy guides, they are by no means the final arbiters of policy decisions which remain based on an eclectic blend of economic, inflation and exchange rate considerations. Whether the central bank is "fine tuning" as much as some believe remains a matter of debate. But, with mechanical money supply targeting in disfavor, Fed governors have to read the tea leaves, too, and, if the outlook changes, so, too, should policy.

Monetary Policy Looks Stable

At the moment, monetary policy remains in a holding pattern, despite the gyrations in the financial markets in anticipation of the next policy move. Last week, for example, the average Federal funds rate stood approximately where it did at the end of last year. This appears to be consistent with a belief among Fed policymakers that while the threat of recession may have diminished,

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits of $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (4/6/88)	180,397	– 1,162	+ 11,483
New York City (4/13/88)	37,816	+ 205	+ 2,000
Commercial Paper			
(4/13/88)	390,558	+ 3,293	+ 49,222

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (4/6/88)	297,935	+ 4,357	+ 7,549
New York City (4/13/88)	55,564	– 1,357	– 6,994

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (4/6/88)	876,081	+ 3,977	+36,582
New York City (4/13/88)	172,410	– 1,519	–35,124

Financial Markets

	Friday 4/22/88	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	5.97%	– .07	+ .08
180-Day Bills†	6.50	–0–	+ .26
Longest Bills†	6.98	– .05	+ .22
Recent Issues:			
7¾s 3/31/90	7.58	+ .01	
7⅞s 3/31/92	8.07	+ .03	
8¼s 2/15/98	8.76	+ .03	
8⅞s 8/15/17	8.99	+ .05	
Municipals:			
Bond Buyer–20 Bond Index* (4/21/88)	7.87%	+ .06	+ .05
Blue List Total ($ Million)	$1,156	+ $ 84	–$ 675
30-Day Visible Supply ($ Million)	$2,175	+ $592	–$1,204
Total	$3,331	+ $676	–$1,879
Corporates:			
Moody's Aa Composite (4/21/88)	9.89%	+ .06	+ .62
30-Day Visible Supply ($ Million)	$3,523	+ $ 99	–$2,486
Stocks:			
Dow-Jones Averages:			
Industrials	2,015.09	+ 1.16	–220.28
Transportation	847.67	+ 14.34	– 65.80
Utilities	169.87	+ .71	– 29.46
65 Stocks	752.07	+ 4.18	– 83.10
N.Y.S.E. Composite Index	147.03	+ .03	– 12.34
N.Y.S.E. Avg. Daily Vol. for Week (000's)	155,156	– 29,616	–18,837

*34% Taxable equivalent 11.92%. † Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 4/22/88	Week Ago
Overnight	6.63%	6.75%
1 month	7.00	6.88
3 month	7.19	7.06
6 month	7.38	7.25
1 year	7.75	7.63
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 yrs.)	9.18%	9.18%
Long Term (10 yrs.)	10.12	10.12

FOREIGN EXCHANGE SPOT RATES

New York Opening (4/22/88)	Currency Per U.S. $	Week Ago
Canada	1.2346	1.2330
France	5.6770	5.6490
Germany	1.6725	1.6620
Italy	1242.50	1234.50
Japan	124.70	123.81
Mexico	2273.00	2273.00
Switzerland	1.3823	1.3722
U.K.*	1.8890	1.8895

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (4/22/88) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	+0.8%	–6.7%

such weak spots in the economic fabric as a good chunk of the Texas banking system, the volatile stock market and the debt problems of the developing countries cannot yet be ignored.

Having said all this, it's now our turn to play the policy guessing game. While the bond markets seem to believe that higher price inflation and recent dollar weakness almost guarantee a tightening of the credit screws, this line of reasoning may be premature, at least. For one thing, as the industrial production numbers suggest, the economy is a long way from overheating. For another, inflation concerns have been exaggerated for at least a year now and, as another Fed governor recently stated, the 0.6 percent increase in producer prices in March could well be an aberration.

Finally, the slide of the dollar in the wake of the widening of the trade deficit has apparently been stemmed by sizable direct central bank intervention, rather than by greater policy restraint. This costly operation indicates perhaps more than anything else that the Fed is not yet inclined to firm policy—bond market gyrations notwithstanding. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 4/20/88	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	228.748	+ .856	+16.160
Loans to Depository Inst.	3.672	+ .107	+ 2.453
Float	– .103	– .661	– 1.615
Total Reserve Bank Credit	247.810	+ .454	+15.745
Treasury Deposits with Federal Reserve Banks	3.662	+ .206	– 1.096
Currency in Circulation	228.766	– .131	+18.486
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	229.118	+ 2.354	+53.763
	4/20/88		
Member Bank Reserves:			
Total Reserves Held	60.689	+ 2.272	+ 1.258
Excess (Deficiency)	.798	– .095	– .006
Net Free Reserves	.457	– .113	+ .342
Monetary Aggregates †		**‡ % Change Since 3 Months Ago***	**Year Ago**
M1 (4/11/88)	766.2	+ 7.6	+ 4.1
M2 (4/11/88)	2,991.2	+ 10.3	+ 5.1
M3 (4/11/88)	3,756.6	+ 9.0	+ 6.0
Domestic Nonfinancial Debt (4th Q'87)	8,361.5	+ 10.2	+ 10.0

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 4/22/88	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	5.82%	6.22%	6.58%
* Federal Agencies	6.68	6.82	6.85
* Municipal Notes—High Grade (34% Taxable Equivalent)	6.67	7.12	7.27
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	7.05	7.15	7.40

‡ Finance Company Paper—Prime

5- 14 days	6.60%
15- 29 days	6.80
30- 59 days	6.83
60- 89 days	6.83
90-179 days	6.81
180-239 days	6.75
240-270 days	6.75

‡* Bankers' Acceptances

May	6.75%
Jun.	6.77
Jul.	6.80
Aug.	6.85
Sep.	6.90
Oct.	6.90

‡ Industrial Paper—Prime

30- 89 days	6.86%
90-120 days	6.92

† Federal Funds Effective Rate 6.85%

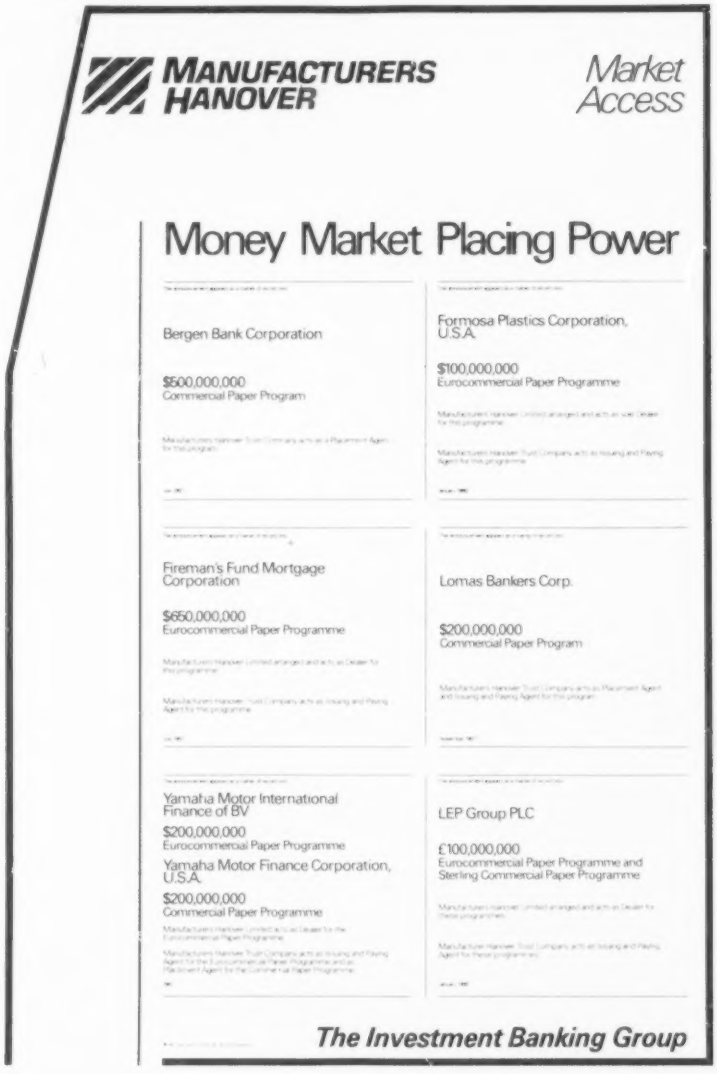
‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'87	$ 4,607	$ 4,524	$ 4,288
Gross National Product (1982 Dollars)*	4th Q'87	$ 3,881	$ 3,836	$ 3,732
Percent Change, Annual Rate	4th Q'87	4.8	4.3	1.5
Change in Consumer Prices*	Mar '88n	6.0%	2.4%	4.8%
Change in Producer Prices*	Mar '88n	7.2%	– 2.4%	4.8%
Civilian Employment (Thousands of Persons) †	Mar '88	114,103	114,409	111,455
Unemployment as % of Civilian Labor Force †	Mar '88	5.6%	5.7%	6.5%
Personal Income*	Feb '88	$ 3,914	$ 3,880	$ 3,671
Leading Indicators Composite Index (1967=100) †	Feb '88	190.6	188.9	186.0
Industrial Production Index (1977=100) †	Mar '88n	134.6	134.4	127.4
Net Change in Consumer Installment Credit †	Feb '88	$ 5.30	$ 6.24	$ 2.65r
U.S. Merchandise Trade Balance	Feb '88n	–$ 13.83	–$ 12.44	–$ 14.36
Plant and Equipment Expenditures*	2nd Q'88n	$427.09(a)	$422.75(a)	$377.65
Private Housing Starts (Thousands of Units)*	Mar '88n	1,543	1,514r	1,723
New Construction Expenditures*	Feb '88	$ 391.5	$ 392.5	$ 401.6
Total Business Inventories †	Feb '88n	$ 715.9	$ 715.0r	$ 665.7r
Total Business Sales †	Feb '88n	$ 468.3	$ 465.7r	$ 442.4r

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.



MANUFACTURERS HANOVER

Manufacturers Hanover Corporation
Bank Window, Church St. Station
New York, N.Y. 10015

First Class Mail
U.S. Postage
PAID
New York, N.Y.
Permit No. 585

463 5883 C 939 SRI A0001
SRI ACQUISITIONS
CONGRESSIONAL INFORMATION
452 EASTWEST HIGHWAY
SUITE 800
WASHINGTON, DC 20014